84-307

NO. ____

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CLERK

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1984

SOUTHERN BANCORPORATION, INC.
AND ITS SUBSIDIARIES,
Petitioner,

vs.

UNITED STATES OF AMERICA,
Respondent.

On Certiorari To The United States Court of Appeals For The Fourth Circuit

PETITION FOR A WRIT OF CERTIORARI

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August 28, 1984

42 pp

QUESTIONS PRESENTED

Whether a Court of Appeals, in reviewing a determination of the fair market value of an asset for federal income tax purposes, may substitute its judgment of the credibility of witnesses and the weight of the evidence for that of the District Court.

Whether, in evaluating the evidence, the nonadjudicatory determination of an administrative agency, the Internal Revenue Service, is to be given more weight than the factual findings of a United States District Court judge.

INTERESTED PARTIES

The following persons have an interest in the outcome of this case:

Southern Bancorporation, Inc. and Subsidiares (Petitioner)

United States of America (Respondent).

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OPINION BELOW

The opinion of the Court of Appeals is officially reported as Southern Bancorporation, Inc. v. United States, 732 F.2d 374 (4th Cir. 1984),

and is reproduced in Appendix A at pages A-1 through A-22.

JURISDICTION

The judgment of the Court of Appeals for the Fourth Circuit was entered on April 17, 1984. (A-72) A Petition for Rehearing and En Banc Consideration was denied on May 30, 1984. (A-74) This Petition for Certiorari was filed within 90 days of the date on which the Petition for Rehearing was denied.

The Court's jurisdiction is conferred under 28 U.S.C. § 1254.

FEDERAL RULE OF CIVIL PROCEDURE INVOLVED

Rule 52(a) of the Federal Rules of Civil Procedure provides:

> Rule 52. Findings by the Court.
>
> (a) Effect. In all actions tried upon the facts without a

jury or with an advisory jury, the Court shall find the facts specially and state separately its conclusions of law thereon, and judgment shall be entered pursuant to Rule 58; and in granting or refusing interlocutory injunctions, the Court shall singularly set forth the findings of fact and conclusions of law which constitute the grounds of its action. Requests for findings are not necessary for purposes of review. Findings of fact shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge the credibility of the witnesses. The findings of a

master, to the extent that the Court adopts them, shall be considered as the findings of the Court. If an opinion or memorandum of decision is filed, it shall be sufficient if the findings of fact and conclusions of law appear therein.

STATEMENT OF THE CASE

Petitioner is Southern Bancorporation, Inc., a South Carolina corporation, and its wholly owned subsidiaries (herein called "Southern"). Petitioner requests that the Court set aside the reversal by the Court of Appeals for the Fourth Circuit of a decision by the United States District Court for the District of South Carolina in a federal income tax refund suit. Upon review of the decisions by the courts below, it will

be apparent that the Circuit Court ignored the record, the inferences drawn by the District Court from the record, the provisions of Rule 52(a) of the Federal Rules of Civil Procedure and the decisions of this Court and substituted its findings of fact for those found by the District Court. In ruling for the government the Circuit Court overlooked the absence of any evidence in support of the government's position and accepted the out of court assertions of an Internal Revenue Service agent over the findings of a United States district judge.

For the taxable year 1974, the Internal Revenue Service disallowed deductions claimed by Southern for the amortization of a loan portfolio. Southern paid the tax resulting from the disallowance of the deductions and,

pursuant to 26 U.S.C. § 7422, brought suit against the Respondent for the refund of that amount in the United States District Court for the District of South Carolina. Jurisdiction existed in the district court pursuant to 28 U.S.C. § 1346(a).

The deduction at issue in the tax refund case related to Southern's acquisition of certain assets of a failed South Carolina bank ("ABT") by assuming some of its liabilities. Among the assets acquired were a loan portfolio and the deposit relationships with the remaining customers of ABT who had not been frightened by the publicity of the bank failure. The purchase was made from the Federal Deposit Insurance Corporation ("FDIC") as liquidator of the assets of ABT. (A-3, A-28--A-30)

Except as to $5,560,000, the parties stipulated before trial to the allocation of a lump sum purchase price paid by Southern for the assets of ABT. (A-47--A-48) The only issue to be decided by the District Court was whether, as contended by Southern, the purchased loan portfolio had a basis for federal income tax purposes of $4,993,940 and $566,060 was allocable to nonamortizable assets. The government claimed that all of this amount was allocable to the "goodwill" or going concern value of the failed bank.

After considering the evidence presented at a two day bench trial, including the testimony of witnesses, the exhibits introduced, the partial stipulation of facts and the argument of the parties, the District Court made extensive findings of fact as to the

background of the acquisition of the failed bank, the manner in which the purchase price had been calculated and the method by which the loans had been valued and their useful lives determined. (A-27--A-64) The District court found as the ultimate fact that the tax basis of the loan portfolio was in the amount claimed by Southern. (A-56, A-60)

The District Court's evaluation of the evidence offered took into account the government's presentation of its case. As to the government's case, the District court stated, "the Defendant presented no evidence or calculations challenging the valuation technique for the commercial loans, relying instead on argument of counsel to attack the evaluation process." (A-55) Similarly,

no evidence was presented by the government to contradict the valuation method used by Southern for the installment loans. (A-58)

The government brought forward only one witness, who was not retained or prepared to speak to the issues being litigated. Rather, he testified to the hypothetical value of a hypothetical operating bank, ignoring the value of the asset at issue--the loan portfolio of a failed bank. The District Court apparently discounted the testimony of the government's expert as not being relevant.[1/]

Also, the the District Court stated that it had considered the

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[1/] On appeal, the government did not rely on its expert's testimony to support its case.

argument of government counsel relating to purported defects in the method by which the loans had been valued by Southern. However, the District Court found that the testimony of Southern's witnesses established that the valuation process used by Southern did not have the defects alleged by the government. (A-59)

The District Court also made specific findings that the testimony of Southern's witnesses was credible. The opinion testimony was found to be reasonable and by persons with expertise in the area. (A-53, A-55, A-59) Based upon the underlying facts established by Southern, the District Court concluded that Southern had met its burden of proof in establishing that the value of the assets acquired were separable from

the values of any nondepreciable assets that may have been present, such as goodwill or "going concern" value. (A-67) Included within this finding was the District Court's determination that the quantum of proof adduced by Southern accounted for the fact that the purchase agreement between Southern and the FDIC did not provide for a specific allocation of the purchase price amount that was in dispute. The ultimate fact found by the District Court was that the tax basis of the loan portfolio was the amount used by Southern in preparing its income tax return. (A-70-A-71) The District Court, therefore, awarded the refund sought.

The government appealed the adverse decision to the Fourth Circuit Court of Appeals. The Court of Appeals

reversed the judgment of the District Court and ordered that judgment be entered for the government without any further proceedings by the District Court.

The opinion of the Fourth Circuit does not acknowledge that its review was restricted by Rule 52(a) of the Federal Rules of Civil Procedure (hereinafter referred to as Rule 52(a)). The opinion further evidences that the Circuit Court proceeded to make its own factual findings--findings which were completely contrary to those made by the District Court. At no time did the Fourth Circuit state any reason why the findings of the District Court were clearly erroneous. Nor did the Circuit Court explain what, if any, legal error had been made by the District Court.

Specifically rejected by the Court of Appeals was the District Court's findings as to the credibility of witnesses and the reasonableness and validity of the opinion testimony presented. Additionally, without explanation as to the basis for its conclusion and without any citation to the record, the Fourth Circuit characterized the deductions claimed by Southern as "approaching fraud" (A-3) and the act of their accountants as "aiding and abetting" (A-10).

The Fourth Circuit appears to premise its reversal of the findings of the District Court on its view that Southern had failed to meet the burden of proof required to sustain the allowance of the deduction. (A-21) The Circuit Court did not allocate the amount at issue to any other asset; nor

did that court remand the matter to the District Court for further findings of fact. (A-22)

Southern requested a rehearing and en banc consideration, which was denied by the Fourth Circuit. (A-74)

ARGUMENT

I.

THE DECISION OF THE FOURTH CIRCUIT THREATENS THE ROLE OF THE DISTRICT COURT AS THE JUDGE OF THE CREDIBILITY OF WITNESSES AND THE WEIGHT OF THE EVIDENCE.

The federal judicial system is structured so that fact-finding is the basic responsibility of district courts, rather than appellate courts. The requirement of Rule 52(a) that deference be given to the factual findings of a district court, unless shown to be clearly erroneous, embodies this role of the district court as the fact finder.

The decision of the Fourth Circuit discounted and effectively eliminated the role of the trier of fact as the judge of the credibility of witnesses and the weight of the evidence. In doing so, the Court of Appeals completely disregarded both the command and the policy underlying Rule 52(a). This disregard of Rule 52(a) was without even a purported attempt to show that a legal error had been made by the District Court or that the factual findings were clearly erroneous.

When the Court of Appeals cast the actions of Southern arising in the context of an ordinary civil tax dispute in such perjorative terms as "bordering on fraud" and those of its accounting firm as "aiding and abetting", that court directly usurped the role of the

District Court in judging the credibility of witnesses. (A-3)

The District Court had made specific findings that Southern's evidence was credible and reasonable. (A-55, A-61) This finding applied both to the testimony presented by witnesses for Southern as to the background of the acquisition of the ABT assets and how the income tax deduction was computed. At no time during the trial did the government assert that there had been any wrongdoing on the part of Southern. Yet, the entire tenor of the Fourth Circuit's opinion is that Southern knowingly claimed an improper deduction. In order for the Fourth Circuit to have reached such a conclusion, the Court of Appeals would have to have made its own finding as to Southern's intent when it calculated the

deductions at issue and filed its tax return. State of mind determinations are generally left to the trier of fact with only deferential appellate review.[2/] Pullman-Standard v. Swint, 456 U.S. 273, 288-289 (1982); Busch v. Commissioner, 728 F.2d 945, 949 (7th Cir. 1984).

Additionally, the Fourth Circuit rejected, without stating a reason, the weight given to the evidence by the trial court. The Court of Appeals held that the government should prevail, not based on the evidence it presented, but

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[2/] The issue of the amortization of an intangible asset, such as the loans, does not normally raise questions of intent. To the extent a question of intent was relevant to the allowability of the deduction at issue, it clearly does not rise to the level of a "constitutional fact question" as was presented in Bose Corporation v. Consumer's Union of the United States, Inc., 52 U.S.L.W. 3513 (April 30, 1984).

because of the initial presumption of correctness attaching to an assertion by the Internal Revenue Service. The Fourth Circuit, thus, gave more credence and weight to the conclusion of an Internal Revenue Service agent, who initially established the position of the government, than to the findings of a United States district judge who heard and reviewed the evidence.

The conclusion of the Service relied upon by the Fourth Circuit was not an adjudicatory determination. Rather, the Service's position was merely the agent's assertion of additional liability based on his view of the facts and the law, as reflected in the statutory notice of deficiency issued by the Service. See 26 U.S.C. § 6214. At no time prior to the position

of the Service being established was any impartial consideration given to the positions taken by Southern, as the taxpayer, and the Service, as the tax collector.

Accordingly, if unreviewed by this Court, the decision of the Fourth Circuit will stand as a repudiation of prior holdings by this Court and of the policies upon which Rule 52(a) is based. Such a repudiation will harm the judicial system by undermining its efficiency and distorting the roles of the trial and appellate courts.

The decision of the Fourth Circuit poses a threat to the efficiency of the federal court system. The district courts have a unique place in the system as the finders of fact. DeMarco v. United States, 415 U.S. 449, 450 (1974);

Malat v. Riddle, 383 U.S. 569, 572 (1966); Zenith Radio Corp. v. Hazeltine Research, Inc., 395 U.S. 100, 123 (1969).

If unreviewed by this Court, the Fourth Circuit's decision will stand as an invitation to the losing litigant to prolong the process by the appeal of a factual issue. The Chief Justice has noted that there already exists a trend whereby "people tend to be less satisfied with one round of litigation and are demanding a 'second bite at the apple' far more often than in earlier times." Burger, Isn't There a Better Way? 68 A.B.A.J. 274, 275 (1982). The decision of the Fourth Circuit will exacerbate this trend and increase the burden on a federal court system which already labors under an ever increasing

workload. Want, The Caseload Monster in the Federal Courts, 69 A.B.A.J. 613 (1983).

Also harmed are those persons who must litigate factual questions. An appellate court does not have the opportunity to view the demeanor and forthrightness of the witnesses. On appeal, the losing party below, through argument of counsel, can obfuscate the testimony through emphasis upon certain words and phrases out of context. The result is that testimony may be perceived by an appellate court differently from how it was actually conveyed before the trial court. A written transcript does not convey to the reader the intonation given to words and the nonverbal communication that can be observed by the trial court. Such

observations become a part of the trial judge's memory and, therefore, are a part of his or her evaluation of the case. The judges of the Court of Appeals do not have before them this unique aspect of the record. It is the lack of opportunity of an appellate court to see and hear witnesses that underlies the rule that deference is to be given to the factual findings of the trier of fact. If an appellate court is permitted to make forays into the domain of the district court by rejudging the credibility of witnesses, the litigants have effectively been denied the right to an adequate trial at which their witnesses may be seen and heard.

II.

THE DECISION OF THE FOURTH CIRCUIT IS IN DIRECT CONFLICT WITH DECISIONS OF THIS COURT AND OTHER CIRCUITS.

This Court has previously held that all factual findings, including those of ultimate fact, are subject to review under Rule 52(a) and any further factual questions to dispose of the issue are to be made by a district court on remand. Pullman-Standard, 456 U.S. at 287. The decision of the Fourth Circuit in this matter and its disposition of the case is in direct conflict with the holdings in Pullman-Standard.

The ultimate issue in the case decided by the Fourth Circuit was the fair market value of an asset for federal income tax purposes. The

question of fair market value is purely factual. Anderson v. Commissioner, 250 F.2d 242, 249 (5th Cir. 1957); Sisto Financial Corporation v. Commissioner, 149 F.2d 268, 269 (2d Cir. 1945).

The District Court made a finding as to the amount of that value. In its answering brief to the government's appeal, Southern urged that the findings of the District Court were subject to review under the standards of Rule 52(a). Without ever acknowledging Rule 52(a) or its principles, the Fourth Circuit rejected the factual findings of the District Court and substituted its own view of the evidence, both as to the ultimate fact, the income tax basis of the loans, and at least three other specific findings by the District Court. The Court of Appeals overturned

the findings of the District Court without giving any explanation as to why the District Court's determinations were faulty.

One instance is when the District Court found the evidence presented by Southern to be credible. In contrast, the Fourth Circuit impugned the veracity of Southern and its witnesses by characterizing their conduct as "approaching fraud."

Secondly, the District Court found that, at the time Southern calculated its bid:

> they believed that the loan portfolio to be obtained in the transaction was more valuable than its face amount of $40,974,953 because they thought that the quality of the commercial loans was high; the yield on both commercial and installment loans was higher than Southern was then achieving on loans it had in its existing loan portfolio; and the loans could be acquired without

> the related costs for underwriting and originating the loans." (A-51--A-52)

Disregarding this finding and inserting its own view of the evidence, the Court of Appeals found that "SBC [Southern] did not, in any event, evaluate the quality of loans prior to purchasing them." (A-17)

Additionally, the Fourth Circuit says that Southern failed in its case because sufficient evidence was not presented to sustain the value of the loan portfolio. In the Fourth Circuit's view, Southern had a greater burden of proof than would normally be required because the purchase agreement with the FDIC did not allocate the amount at issue to the loans.[3/] In evaluating

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[3/] The cases relied upon by the Fourth Circuit were Markham & Brown,

[Footnote continued on next page]

whether Southern had satisfied its burden of proof, the District Court had made specific reference to the fact that it was considering a case where the purchase agreement did not contain the allocation urged by the taxpayer. (A-67) Thus, the holding of the Fourth Circuit was merely a substitution of its view of the weight of the evidence for that which had been found by the District Court.

[Footnote 3 continued]

Inc. v. United States, 648 F.2d 1043, 1046 (5th Cir. 1981); Better Beverages, Inc. v. United States, 619 F.2d 424, 429-430, reh'g denied, 625 F.2d 1160 (5th Cir. 1980) (A-16) Those decisions were not analogous since they involved whether part of a lump sum amount was paid for a covenant not to compete when there was no evidence that the parties negotiated to pay any value for such an undertaking.

These examples evidence the disregard of Rule 52(a) by the Court of Appeals. Such action is clearly contrary to the decisions of this Court and those of other Circuits.

In Pullman-Standard, this Court laid to rest the then existing uncertainty as to whether Rule 52(a) applied to all factual findings, even those of "ultimate" facts. Unequivocally, this Court stated:

> Rule 52(a) broadly requires that findings of fact not be set aside unless clearly erroneous. It does not make exceptions or purport to exclude certain categories of factual findings from the obligation of a Court of Appeals to accept a District Court's findings unless clearly erroneous. It does not divide facts into categories; in particular, it does not divide findings of fact into those that deal with "ultimate" and those that deal with "subsidiary" facts.

456 U.S. at 287.

Additionally, this Court has cautioned appellate courts that in reversing factual findings of district courts, they should identify the evidentiary basis for any particular error of the district court. Inwood Laboratories v. Ives Laboratories, 456 U.S. 858, n. 20 (1982). That admonition was not followed by the Fourth Circuit.

As the Fourth Circuit's action in this case completely disregarded this Court's prior holdings, the principles of Rule 52(a) are apparently not clear to all appellate court judges.[4/] A

[4/] This Court's most recent interpretation of Rule 52(a) in the context of the required "actual malice" findings for New York Times Co. v. Sullivan, 376 U.S. 254 (1964), does not depart from the adherence to Rule 52(a) mandated by Pullman-Standard and Inwood Laboratories. The majority opinion in Bose

[Footnote continued on next page]

review of this case offers the opportunity to again define and reinforce the respective roles of the trier of fact and the appellate court and to dispel the remaining uncertainty as to how Rule 52(a) is to be applied.

The Fourth Circuit also ignored the rulings of this Court when it ordered that a judgment be entered for the government without further proceedings by the District Court. This case illustrates the procedural problems and the duplicative litigation that can result from such a failure.

[Footnote 4 continued]

limited the role of the appellate court as the independent reviewer of the facts to those cases involving First Amendment rights for which a constitutional responsibility cannot be delegated to the trier of fact. Bose, 52 U.S.L.W. at 4517.

When the Court of Appeals held that Southern was not entitled to the amortization deduction for the year at issue because it failed to carry its burden of proof, that holding did not completely resolve the controversy. While the Fourth Circuit held that the purchase price at issue ($5,560,000) could not be attributed to the loan portfolio, it did not specify how this amount was to be treated for federal income tax purposes.[5/]

[5/] Based on the stipulation of the parties, the purchase price at issue could only be attributed to either the deposit relationships with the customers of the failed bank or to going concern value. It is established, and recognized by Southern, that going concern value is a nonamortizable asset. However, deposit relationships are amortizable for tax purposes.

[Footnote continued on next page]

Usually, when a Court of Appeals has found the record to be missing a finding on a dispositive point or when findings are infirm because of an erroneous view of the law, a remand to the District Court should be made because:

> Fact finding is the basic responsibility of district courts, rather than appellate courts and, . . . the Court of Appeals should not have resolved in the first instance this factual dispute which had not been considered by the District Court.

[Footnote 5 continued]

Midlantic National Bank v. Commissioner, 52 T.C.M. (P-H) 1983-581 (1983). In order to obtain an answer to the question not answered by the Fourth Circuit, Southern, as to other tax years that are affected, is being required to seek a further determination as to the proper tax treatment. A proceeding is now pending in the United States Tax Court on this question as to years not in issue before the District Court.

DeMarco, 415 U.S. at 450, n*. While the necessity of a remand should have been an accepted procedure, the Fourth Circuit did not adhere to this rule.

Consistent with the principles enunciated in Pullman-Standard and Inwood, other circuit courts have adhered to the requirements of Rule 52(a). The following decisions, involving like situations of extensive factual findings by the District Court, correctly held that Rule 52(a) required that deference be given to the factual findings of the district court. Trout v. Lehman, 702 F.2d 1094, 1100 (D.C. Cir. 1983), vacated, 79 L.E.2d 732 (1984); Chicago Title Insurance Company v. Sherred Village Associates, 708 F.2d 804, 810 (1st Cir. 1983); Lyddan v.

United States, 721 F.2d 873, 875 (2d Cir. 1983); Bittner v. Borne Chemical Company, Inc., 691 F.2d 134, 138 (3d Cir. 1982); Byram v. United States, 705 F.2d 1418, 1422-1423 (5th Cir. 1983); Busch, 728 F.2d at 949; Robino v. Norton, 682 F.2d 192, 195 (8th Cir. 1982). Similarly, other circuit courts have correctly recognized that "[u]nder the clearly erroneous standard, we [the court of appeals] cannot reweigh the evidence." Busch, 728 F.2d at 951. The decision of the Fourth Circuit in this matter is clearly in conflict with those decisions. The Fourth Circuit gave no deference to the District Court's factual findings or to the weight accorded the evidence by that court.

CONCLUSION

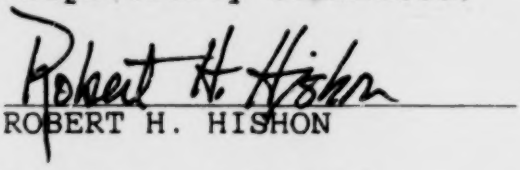
The significance of this case reaches much beyond a tax dispute. It

is the integrity of the federal judicial system and the role of a district court as the finder of fact which requires consideration by this Court. If the Fourth Circuit's opinion remains unreviewed, it will stand as an open invitation for increased use of the appellate courts to relitigate factual issues. Such a result is contrary to all efforts now being made to relieve the overcrowing of the federal court system.

Further, the decision below is clearly in conflict with the holdings of this Court in Pullman-Standard, Inwood Laboratories, and Bose.

A writ of certiorari should, therefore, be granted to review, and ultimately reverse, the decision below.

Respectfully submitted,



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August 28, 1984

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UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

No. 83-1838

Southern Bancorporation, Inc. and Subsidiaries; World Finance Corporation of Americus; Southern Bank and Trust Company; Colonial Loan and Finance of Albany; Belvedere Finance Company, Inc. of Anderson; World Finance Corporation of Palestine and World Finance Corporation of Texas City,

Appellees.

v.

United States of America,

Appellant.

Appeal from the United States District Court for the district of South Carolina, at Greenville, G. Ross Anderson, Jr., District Judge.
(C/A 82-2018 - 82-2024)

Argued: February 9, 1984
Decided: April 17, 1984

Before MURNAGHAN and CHAPMAN, Circuit Judges, and PECK,* Senior Circuit Judge.

Farley P. Katz, Tax Division, Dept. of Justice (Henry Dargan McMaster, United States Attorney; Glenn L. Archer, Jr., Assistant Attorney General; Michael L. Paup, Jonathan S. Cohen, Tax Division, Dept. of Justice on brief) for Appellant; Robert H. Hishon (M. Celeste Pickron, Bondurant, Miller, Hishon & Stephenson; Francis Marion, Anne S. Ellefson, Haynesworth, Perry, Bryant, Marion & Johnstone on brief) for Appellees.

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* The Honorable John W. Peck, Senior Circuit Judge, United States Court of Appeals for the Sixth Circuit.

MURNAGHAN, Circuit Judge:

The application of the Federal income tax laws may seem to some prosaic; nevertheless, the opportunities for ingenuity, even ingenuity approaching fraud, are many. Here we observe a failed effort, imaginative but unavailing, on a taxpayer's part.

The Southern Bank Corporation, Inc. together with its wholly-owned subsidiaries here involved (SBC) was one of several prospering financial institutions approached by the Federal Deposit Insurance Corporation (FDIC) to participate in a bail-out for a competing financial giant, American Bank and Trust Company (American), which had fallen on evil days. The scheme envisaged to accomplish the desirable

objective of avoiding a bank failure, with its inevitable disquieting consequences, invited bids for certain of the assets:

Assets to be Purchased by Assuming Bank (All values approximate)	
A. Cash, cash items in process of collection, amounts due from Bank and securities (book values)	$ 41,000,000
B. Loans--All loans except loans adversely classi-filed by FDIC and all loans other than installment loans held at Orangeburg and Columbia branches	$ 38,000,000
C. Fixed Assets . .	$ 2,700,000
D. Other Assets (Accounts re-ceivable, income earned, prepaid expenses, etc.) .	$ 1,500,000
TOTAL	$ 83,200,000

The loan portfolio did not include all loan items. There were certain exclusions, approximating $61,000,000, for those pieces in default or otherwise of questionable worth.

As assets covered by the sale were the sites of 29 branches of American, located in 20 different communities, to be transferred through assumption of leases or otherwise. With those assets would go along the opportunity to approach the employees of American theretofore wo king in those branches in order to continue the branches in business on a going-concern basis.

Also, the successful bidder, as a distinct part of the purchase price, was required to assume certain liabilities of American amounting to $136,000,000. The FDIC undertook to make up in cash

the gap between assets and liabilities, after reduction by the amount offered by the successful bidder as a premium. As it turned out the liabilities assumed by SBC under its successful bid exceeded book value of the assets and the FDIC cash contribution by $5,560,000.[1/]

The opportunities, formally at least, for valuing in order to compare the offers of the competing entities on a differing basis were, consequently, restricted to how much of the "price" would be assigned to the going-concern

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[1/] After post-closing adjustments, the exact amount of the difference was $5,535,412, calculated by showing the face amount of the loans as $40,974,953. In light of a stipulation by the parties, the earlier estimated figure of $5,560,000 was utilized throughout the trial.

worth of the branches. That, in turn, would depend on the extent for a fit, i.e., on how far assumption of a branch would open up a new marketing area for the successful bidder not already served by its existing facilities. Ten of the American branches were located in communities in which American alone had offered banking services. SBC had had no branches in any of the 20 communities in which the actively operating businesses acquired from American were located.

The best offer received by the FDIC and the one accepted in September 1974 came from SBC. The premium, as already indicated, amounted to $5,560,000.

In computing the bid to make, SBC tested an approach involving a premium

calculated as approximately 5% of American's total deposits of $112,000,000. SBC used the method because the Crocker National Bank in San Francisco recently had successfully bid 5% of the deposits of a failed bank to acquire it from the FDIC. SBC looked to whether a transaction so structured would be profitable. SBC determined that amortizing the premium over 40 years (i.e., $137,500 per year) would afford SBC an annual profit. On that basis the bid was firmed up and submitted.

It should be self-evident that computation of the premium by reference to the deposit base was but another way of expressing concern that the acquired former branches of American in which savings accounts and checking accounts

were maintained by customers would continue to operate as part of SBC. It was the on-going use of that deposit base of $112,000,000, located in the 29 branches, as a source from which to make profitable loans which made the branches things of value to SBC. Hence, the value of the 29 branches, or, more especially, of the deposits of their customers, constituted a paramount consideration in SBC's calculation of the premium it would offer.[2/]

[2/] The record is devoid of any basis for establishing an amortization rate applicable to the premium based on the expected life of the accounts involved. Cf. Midlantic National Bank v. Commissioner, 46 TCM 1464 (1983). SBC's complaint raised, as an alternative ground for relief, the issue of amortizing the deposit base.

(footnote continued on next page)

When income tax time came around, SBC, aided and abetted by Peat, Marwick Mitchell & Co., reassigned values to the properties acquired, primarily to increase the values of the loan portfolio components by $4,993,940[3/] and to shrink the going-concern value,

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[2/] (Footnote continued from previous page.)

However, SBC did not pursue the issue at trial and prove its alternative allegations that it paid $4,202,361 for the deposit base, and that the deposit base had a useful life of less than ten years.

[3/] An intangible asset, such as a loan portfolio, can be amortized if the "intangible asset is known from experience or other factors to be of use in . . . the production of income for only a limited period, the length of which can be estimated with reasonable accuracy." Treas. Reg. Section 1.167(a)3. By reassigning the bulk of the premium to the loan portfolios

(Footnote continued on next page)

to $566,060 ($5,560,000 - $4,993,940). Going-concern value was not an amortizable item.[4/]

The techniques employed to achieve the upward reevaluation included classification of the installment loans as extremely high in quality, on the

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[3/] (Footnote continued from previous page)

(i.e., $2,839,022 to the installment loan portfolio, which had a useful life of 20.91 months, and $2,154,918 to the commercial loan portfolio, which had a useful life of 4.38 years), American attempted to convert non-amortizable values to amortizable ones.

[4/] It has been long settled that goodwill is not amortizable. See Dodge Brothers, Inc. v. United States, 118 F.2d 95, 100 (4th Cir. 1941). Going concern value, which is akin to goodwill, is also non-amortizable. See Northern Natural Gas Co. v. United States, 407 F.2d 1107 (8th Cir. 1972), cert. denied, 412 U.S. 939 (1973).

grounds that the FDIC had purified the portfolio by eliminating bad loans and the further grounds that SBC was spared the expenses of putting the loans, one by one, on its books. As for commercial loans, a sampling approach was employed (the sample included, of a total of 5000 loans, 162 chosen at random, and all over $50,000 in amount). SBC concluded that all loans in the sample were "excellent" (43%), "good" (54%), or "average" (1.597%). None was rated "fair" or "poor". Premiums of 15% were assigned to "excellent loans" and 5% to "good" loans.

The consolidated SBC income tax return prepared for 1974 sought amortization of the $4,993,940 to the extent of $589,241. On that basis, and taking into account other deductions,

SBC claimed a loss for 1974 and sought to carry it back to prior years. When the Internal Revenue Service balked, SBC paid the tax and sued for a refund in the United States District Court for the District of South Carolina. SBC has not only claimed the right to amortize the $4,993,940, but also has put forth the alternative contention that, of the $5,560,000 premium, $4,202,361 should be allocated to the acquired deposits, and that as "cheap money"[5/] that deposit base was a valuable and amortizable asset.[6/]

[5/] Namely, funds of depositors on which interest was not paid or was well below the rates at which loans by a bank could and, no doubt, would be made.

[6/] That alternative contention appears not to have been pursued at trial.

In the expected, and, regrettably, inevitable battle of experts, SBC had one to testify that both the upward revaluation of the loans and the assignment of value to the deposit base were reasonable. The Government adduced evidence to establish that the loans, in aggregate, were worth less, not more, than face, and furthermore that the premium was paid to obtain the going concern value of American's branch banks which was non-amortizable. See note 4 supra.

The district judge determined that, whatever the non-depreciable asset value allocable to the deposit base was, it did not exceed $566,060, and that otherwise the premium was properly allocated to the increased worth assigned by SBC to the loan portfolio.

The district judge further determined that the reasonable life for depreciation had been made out, so that refunds of the contested taxes, together with applicable interest, should be paid.

Section 1012 of the Internal Revenue Code, 26 U.S.C. § 1012, provides that the basis of property shall be the cost of property. On the approach adopted by SBC, there was not an assignment of values to the various components of the deal. Thus, it is difficult to say what the costs of the loan portfolios were.

SBC's attempt to increase the bases of the loan portfolios is wholly post hoc. A purchaser must prove the purchase price, i.e., the cost, at the time of sale. See, e.g., Markham & Brown, Inc. v. United States, 648 F.2d

1043, 1046 (5th Cir. 1981); Better Beverages, Inc. v. United States, 619 F.2d 424, 429-30, reh'g denied, 625 F.2d 1160 (5th Cir. 1980). SBC introduced no evidence to prove that it intended to pay an enhanced value for the loan portfolios at the time of sale. The Fifth Circuit said in Better Beverages: "A taxpayer's failure of proof on this point may not be overcome by abstract arguments, not tethered to the fact of the transaction, as to what might have been a fair and equitable price of apportionment." 619 F.2d at 430 (emphasis in original).

It is evident that the sophistication to apply the techniques on which the refund claim rests would not have been available to any willing purchaser in the relatively short period

from September 5[7] to September 20, 1974. SBC did not, in any event, evaluate the quality of loans prior to purchasing them.

Even if we assume, arguendo, that the bases of the portfolios should be fair market value,[8] SBC's scheme does not pass muster. As SBC asserts:

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[7] September 5, 1974 was the date on which other banking institutions were apprised that assets of American would be auctioned off. Additional information became available only on September 18, 1974, two days before submission of bids was to occur.

[8] Both the Commissioner and SBC assume that fair market value is relevant to the determination of the portfolios' bases. But fair market value has not been sufficiently established by SBC. We note that the Tax Court has said: "Where the issue is to determine the cost basis of an aggregate of assets, including both depreciable and nondepreciable items, it

(footnote continued on next page)

> There is no better evidence of market value than the purchase price paid for an asset in the marketplace in a transaction involving parties acting at arms length.

Here the burden of proof rested on SBC, the plaintiff in the tax refund case. See United States v. Janis, 428 U.S. 433, 440 (1976); see also Welch v. Helvering, 290 U.S. 111, 115 (taxpayer carries burden of proving entitlement to a deduction). SBC did nothing to establish that a sale of the loan

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[8] (Footnote continued from previous page.)

is essential to ascertain the fair market value of the items which are subject to depreciation." Concord Control, Inc. v. Commissioner, 78 T.C. 742, 750-51 (1982), quoting Philadelphia Steel & Iron Corp. v. Commissioner, T.C. Memo. 1964-93, aff'd per curiam, 344 F.2d 964 (3d Cir. 1965).

portfolios on the open market on the sale date, September 20, 1974, by a willing seller to a willing buyer would have yielded any greater sum than that assigned in the valuation formula mandated by the FDIC when it sought bids. There was not even introduced evidence to show that a sale of a loan portfolio all by itself, identical to or reasonably similar to that of American, ever had, or could have, taken place in a fashion producing a fair market value exceeding, or indeed even equalling the aggregate face value. It is entirely possible that any such attempted sale would have assumed distress characteristics in the minds of purchasers, making the likelihood great that fair market value for such a

commodity would be substantially depreciated from face value.

Manifestly, on the other hand, the achieving of ownership of branches of the former owner, American, on an on-going-business basis had a substantial value. The banking customers used to doing business in a certain location were to be expected to return to the location, despite the change in name reflecting a change in ownership. Especially is that the case when it is borne in mind that the take-over occurred during a weekend,[9/]

[9/] The SBC bid was submitted on Friday, September 20, 1974, the day that American closed its doors. On Monday, September 23, 1974, SBC was open for business in all 29 former branches of American.

(footnote continued on next page)

so that there was no interruption of continuity in the conduct of banking business in each of the branches formerly owned and operated by American. The Governor of South Carolina employed techniques assured of ample publicity to emphasize the continued safety of the deposits in the twenty-nine branches taken over by SBC.

In short, SBC's case is comprised exclusively of imagination and speculation. It is insufficient to overcome the presumption of correctness attaching to the acceptance by the IRS

[9/] (Footnote continued from previous page.)

Thereafter, 3 of the branches were closed by SBC, but the other 26 continued to operate as SBC entities for at least the more than 8 years between September 23, 1974 and the trial on April 25 and 26, 1983.

of the computations made in a manner conforming to the structure, and especially the assigned market values, of the transaction between FDIC and SBC. Cf. Compton v. United States, 334 F.2d 212, 216 (4th Cir. 1964) ("It is a well established principle that in every case, whether in a proceeding in a Tax Court to contest a deficiency assessment or in a District Court in a suit for refund, the assessment of the Commissioner is presumed to be correct."). Since the burden of proof has not been met by SBC, it cannot prevail.[10/] The judgment of the

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[10/] Reliance by SBC on Commissioner of Internal Revenue v. Seaboard Finance Co., 367 F.2d 646 (9th Cir. 1966) is misplaced. Substantively it involved acquisition of small loan companies. For them, of course, interest rates for loans were permissibly much greater than for loans of the types in the American portfolio.

district court is reversed and the case remanded with instructions to enter judgment in favor of the Commissioner of Internal Revenue.

REVERSED AND REMANDED.

IN THE UNITED STATES
DISTRICT COURT FOR THE
DISTRICT OF SOUTH CAROLINA
GREENVILLE DIVISION

SOUTHERN BANCORPORATION, INC., and SUBSIDIARIES et al., Plaintiffs,	)	CONSOLIDATED CIVIL ACTION
	)	FILE NOS.
	)	82-2018-3
	)	82-2019-3
v.	)	82-2020-3
	)	82-2021-3
UNITED STATES OF AMERICA,	)	82-2022-3
	)	82-2023-3
	)	82-2024-3
Defendant.	)	

ORDER

These consolidated civil actions were brought for the refund of federal income taxes and tried to the Court sitting without a jury. Having considered the evidence presented at the trial, including the testimony of the witnesses and the exhibits introduced, the material facts set forth in the parties' partial stipulation of facts,

and arguments on behalf of Plaintiffs and Defendant, this Court enters the following findings of fact and conclusions of law in these cases:

FINDINGS OF FACT

1. These consolidated actions for the refund of the overpayment of federal income taxes are properly within the jurisdiction of this Court pursuant to 28 U.S.C. § 1346(a)(1).

2. The plaintiffs in the consolidated actions are Southern Bancorporation, Inc. and its wholly owned subsidiaries, Southern Bank and Trust Company; World Finance Corporation of Americus; Colonial Loan and Finance Company of Albany; Belvedere Finance Company, Inc. of Anderson; World Finance Corporation of Palestine; World Finance Corporation of Americus; and World

Finance Corporation of Texas City (collectively referred to as the "Subsidiaries"). [Stipulation of the Parties No. 2] (The Stipulation of the Parties is hereinafter referred to as "Stip.")

3. The separate actions for refunds of federal income taxes brought by Southern Bancorporation, Inc. and subsidiaries and the Subsidiaries (hereinafter referred to collectively as the "Plaintiffs") were consolidated by the Court's order of January 25, 1983.

4. The Plaintiffs in the consolidated actions claim that they have overpaid their correct federal income tax liability and the interest related thereto, in the following amounts:

Southern Bancorporation, Inc.
and subsidiaries

Year	Amount of Tax	Interest Paid	Total
1974	$ 7,532.26	$ 3,922.88	$11,455.14
1973	36,382.00	19,672.04	56,054.04

Southern Bank and Trust Company

Year	Amount of Tax	Interest Paid	Total
1972	$53,993.32	$15,536.23	$69,529.55
1970	18,158.91	---	18,158.91
1969	11,158.91	---	11,158.91
1968	7,805.96	---	7,805.96

Word Finance Corporation of America

Year	Amount of Tax	Interest Paid	Total
FYE 6/30/73	$341.58	$185.28	$526.86

Colonial Loan and Finance of Albany

Year	Amount of Tax	Interest Paid	Total
FYE 6/30/73	$493.04	$267.43	$760.47

Belvedere Finance Company of Anderson

Year	Amount of Tax	Interest Paid	Total
FYE 6/30/73	$341.50	$185.23	$526.73

Word Finance Corp. of Palestine

Year	Amount of Tax	Interest Paid	Total
FYE 6/30/73	$350.01	$189.84	$539.85

Word Finance Corp. of Texas City

Year	Amount of Tax	Interest Paid	Total
FYE 6/30/73	$372.24	$201.90	$574.14

[Stip. 4]

5. The Defendant does not contest the amounts of the overpayments, only the Plaintiffs' right to refunds.

6. On September 20, 1974, Southern Bank and Trust Company ("Southern") acquired a portion of the assets and assumed a portion of the liabilities of American Bank and Trust, Orangeburg, South Carolina ("ABT"). [Stip.7]

7. ABT was a bank organized under the laws of the State of South Carolina. [Stip. 8]

8. In early September, 1974, the Federal Deposit Insurance Corporation ("FDIC") provided an unlimited line of credit to ABT to enable it to meet its pressing cash needs and to provide time for the FDIC's further review of ABT's situation. Under that agreement, ABT borrowed $9 million from the FDIC. [Stip. 9]

9. Plaintiffs' witnesses, Dr. Olin S. Pugh and Sam Hunt, testified that during mid 1974 adverse publicity concerning ABT and its stability appeared in various national and local newspapers. Dr. Pugh testified that the adverse publicity caused ABT to suffer a

loss of deposits during the weeks preceding its closing.

10. At a meeting held on September 5, 1974, the FDIC disclosed to Southern and five other banking institutions that ABT was experiencing a liquidity problem. [Stip. 10]

11. Mr. Hunt, Southern's chief executive officer, testified that the FDIC initiated a series of meetings to discuss the ABT problem with other South Carolina financial institutions, including Southern. Mr. Hunt said that the FDIC had initiated merger proposals and advised Plaintiffs' officers that if a merger was not feasible, the banks submitting proposals for the merger might later be given an opportunity to purchase the assets of ABT.

12. Southern submitted a letter proposal for a statutory merger, upon certain stated conditions. [Stipulated Exhibit A; Stip. 11]

13. The terms of the merger submitted by Southern and other financial institutions were not acceptable and discussion of the use of a merger transaction was abandoned. [Stip. 12]

14. Subsequently, on September 16, 1974, the FDIC contacted Southern and other banking institutions to request that they attend a meeting on September 18, 1974, for further discussions on the ABT problem and possible solutions. [Stip. 13]

15. The potential acquisition of ABT or its assets was discussed at a joint executive session of Southern

Bancorporation, Inc. and Southern on September 17, 1974. [Stipulated Exhibit B; Stip. 14]

16. On September 18, 1974, the FDIC conducted a meeting with the six financial institutions, including Southern, at which time the FDIC provided additional information on the assets and liabilities of ABT that were to be purchased and assumed. [Stip. 15]

17. Mr. Hummers and Mr. Balentine, executives of Southern, testified that they began evaluating the available information about ABT on September 18, 1974. They concluded that the Southern Bank could reasonably make an offer to purchase the assets described by the FDIC by assuming liabilities of ABT in an amount which

exceeded the book values of the assets by approximately $5 1/2 million.

18. At 9:00 a.m. on Thursday, September 19, 1974, the FDIC informed Southern and other potential bidders that ABT would be closed on September 20, 1974, by the South Carolina State Board of Bank Control, in accordance with Section 8-273, Code of Laws of South Carolina 1962, as amended (Section 34-3-630 of Code of Laws of South Carolina 1976, as amended). Under that statutory procedure, the State Board of Bank Control would then tender receivership of ABT to the FDIC. [Stip. 16]

19. On September 19, 1974, the FDIC furnished Southern and five other South Carolina banking institutions with

a "bid package." [Stipulated Exhibit C; Stip. 17]

20. The summary of the terms of the transaction and the assets and liabilities set out in the "bid package" is as follows:

I. ASSETS TO BE PURCHASED BY ASSUMING BANK (All values approximate)

A.	Cash, cash items in process of collection, amounts due from Bank and securities (book value)	$ 41,000,000
B.	Loans--All loans except loans adversely classified by FDIC and all loans other than installment loans held at Orangeburg and Columbia branches.	$ 38,000,000
C.	Fixed Assets . . .	$ 2,700,000
D.	Other Assets (Accounts receivable, income earned, prepaid expenses, etc.) .	$ 1,500,000
	TOTAL	$ 83,200,000

II. LIABILITIES TO BE ASSUMED

A.	Demand Deposits .	$ 45,000,000
B.	Time and Savings Deposits	$ 72,000,000
C.	Borrowings	$ 15,000,000
D.	Other Liabilities.	$ 4,000,000
TOTAL		$136,000,000

III. ADDITIONAL PROVISIONS

A. Assuming Bank will, to the extent permitted by law, succeed to the Trust business.

B. Assuming Bank will have 90-day option to resell to Receiver up to $3,000,000 of loans purchased.

C. Assuming Bank will have option to purchase any loans retained by Receiver with right of first refusal when Receiver or its assignee offer any loans for sale.

D. Assuming Bank assumes no liability for letters of credit or loan repurchase agreements.

E. Assuming Bank agrees to operate all branches for thirty (30) days from date of purchase--ten (10) branches where no other commercial banking facilities are available to be operated a minimum of six (6) months.

F. Assuming Bank will initially continue to employ all former employees--no minimum term of employment and no obligation under any pension plan, employment contract, etc.

G. Assuming Bank has option to assume leases on 14 branches and lease on Main Street, Columbia, location not yet occupied. Lease options must be exercised within 30 days of purchase, except, Main Street, Columbia, location, whose option must be exercised within 15 days.

H. Assuming Bank (or its parent holding company) will have option to sell to FDIC its interest bearing capital note in the principal amount not to exceed $8,000,000, to mature not more than five (5) years from the date of purchase.

I. Value of real estate, securities, leasehold estates, personalty and certain other assets subject to appraisal and adjustment within ninety (90) days after purchase.

J. FDIC will indemnify Assuming Bank and hold Assuming Bank harmless from all liabilities not expressly assumed pursuant to the Purchase and Assumption Agreement.

K. Assuming Bank agrees to take over operations in all branches on the next business day following purchase without any interruption in Bank's services.

IV. TERMS OF PURCHASE

The difference between assets to be purchased and liabilities assumed will be made up in cash by FDIC--any premium bid by the Assuming Bank will be subtracted from such cash payment.

[Excerpted from Stipulated Exhibit "C"]

21. Southern submitted its bid for the purchase of the assets of ABT at approximately 5 p.m. on September 20, 1974. The bid was made by Southern tendering an executed copy of the Bid (in the form contained in Stipulated Exhibit C, p. 5) with the amount of $5,560,000 inserted as the "Premium to be paid by us." That $5,560,000 is the amount described in section 20 of the Purchase Agreement. [Stip. 19]

22. At 7:45 p.m. on September 20, 1974, the FDIC announced that Southern was the successful bidder to acquire the assets of ABT. [Stip. 20]

23. After acceptance of the bid, representatives of Southern and the FDIC executed and delivered the Purchase Agreement, Indemnity Agreement (in the same form as had been contained in the bid package) and the related documents. [Stipulated Exhibit D; Stip. 21]

24. As a term of the Purchase Agreement, Southern was required to open the former ABT offices on Monday, September 23, 1974 under Southern's name. [Stip. 22]

25. Southern was also required to assume the trust business, safety deposit box obligations, safekeeping arrangements, service contracts, leases

(with some exceptions), and the obligations of ABT to its depositors. [Stip. 23]

26. In order to comply with the undertaking to open the ABT offices as branches of Southern, employees of Southern, after acceptance of the bid, worked on Saturday and Sunday to accomplish the required actions. Groups of employees of Southern Bancorporation were disbursed to the ABT locations. Each group had an "acquisition kit" which contained Southern Bancorporation and Southern decals, general information pertaining to Southern, personnel policies, a cover letter from the Chairman of the Board of Southern Bancorporation, Inc. to the former ABT employees, public relations materials for distribution to the media in each of

the geographic areas in which the ABT offices were located and new Southern signs to cover old ABT signs. [Stip. 24]

27. The employees of Southern sent to each of the ABT offices were instructed to take razor blades and remove all ABT decals and signs from doors and windows. ABT exterior signs were to be dismantled, and signs which could not be dismantled were covered with large sheets of plastic or plastic bags. [Stip. 25]

28. After the announcement of the bidding results, officers of Southern on the evening of September 20, 1974, met with the FDIC to discuss, prepare and coordinate public announcements. After this drafting session, the FDIC and the South Carolina Board of Bank Control made a formal, full-page newspaper

announcement of the acquisition of ABT by Southern. [Stip. 26]

29. After the drafting session was complete, news releases detailing the acquisition were hand delivered to the Columbia, South Carolina television stations and newspapers so that the Friday 11:00 p.m. news and the Saturday morning newspapers would carry the story of the acquisition and the FDIC news release. [Stip. 27]

30. Southern purchased advertising to be broadcast on Saturday, September 21, 1974, on radio stations in Columbia, Orangeburg and Charleston. The format of the ads was a 30-second announcement which stated that ABT had been purchased by Southern and that the doors of the former ABT branches would be open on Monday at 9:00 a.m. as

branches of Southern. The remainder of the spot relayed information about the strength and stability of Southern. The announcements were continued through Saturday and Monday, with a reduced schedule implemented for Tuesday through Friday of that week. [Stip. 28]

31. On September 21, 1974, John West, the then governor of South Carolina, issued a press release relating to the acquisition of ABT by Southern. The press release emphasized that all depositors of ABT were "completely protected" by the acquisition of assets and assumption of liabilities of ABT by Southern Bank. [Stipulated Exhibit F; Stip. 29]

32. Management of Southern prepared television spots for use on Saturday and Sunday and another for use

on Monday and thereafter. The television advertisements were designed to convey that ABT depositors had no reason to fear for the safety of their funds. [Stip. 30]

33. Releases were made by other officials, such as John Lumpkin, the then president of the South Carolina's Bankers Association, to state and reinforce the details of the acquisition and reaffirm faith in the banking system as a whole. [Stip. 31]

34. Also, to create a feeling of security, the state of South Carolina agreed to make a deposit of state funds with Southern at a former ABT location. This deposit was to be covered by the news media for broadcast on television. [Stip. 32]

35. At the time of the acquisition it was not known how many ABT employees would be retained by Southern. High level officers began severing their employment relationships either during or shortly after the extended closing period, which occurred in January, 1975. At the time of trial, Plaintiffs established that of the 84 officers listed in the 1973 ABT annual report only 18 were still employed by the Plaintiffs. [Testimony of John Balentine and Sam Hunt; Plaintiffs' Exhibit 3]

36. The evidence shows overwhelmingly that Southern did not acquire any significant expectation of continued patronage by the former customers of ABT as a result of any of the following: (1) use of ABT's name;

(2) a group of experienced management personnel, or (3) a carryover of good reputation that had existed as to ABT. [Testimony of Dr. Pugh, Mr. Hunt, and Mr. Southerland; Partial Stipulation of Facts; and Findings above]

37. The terms of the acquisition were set out in the Purchase and Assumption Agreement (hereinafter the "Purchase Agreement"). [Stipulated Exhibit "D"] In the bid package [Stipulated Exhibit "C"], the FDIC included schedules of assets to be purchased and liabilities to be assumed as of September 9, 1974. To take into account the date of the asset and liability information and the fact that the potential bidders did not have the opportunity to verify any of the financial information, the Purchase

Agreement provided that the FDIC would prepare new schedules as of the close of business on September 20, 1974. Thereafter, the purchasing bank would have the opportunity to verify the financial information supporting the schedules and adjustments could be made to the purchase price to compensate for accounting inaccuracies. The Purchase Agreement also provided that after acceptance of the winning bid a process would be implemented whereby equipment, real property and personal property would be subject to an appraisal procedure. The value of securities was subject to adjustment based on market quotations. The point of the adjustment procedure was to establish the purchase price so that it reflected the fair market value on a going concern basis,

of securities, equipment, real and personal property, rather than as calculated using the carrying value on ABT's books. The post-closing adjustment procedure to determine the value of assets acquired served the same function as pre-sale negotiations that normally occur between a willing buyer and seller prior to the consummation of a sale. [Testimony of William Hummers; Stipulated Exhibits "C" and "D"]

38. After taking into consideration all eliminations, returns, additions and other post-closing adjustments, Southern had acquired, obtained or assumed the following, exclusive of loans and any other unspecified intangible assets:

Assets	
Cash and Due from Banks	$ 10,558,103

Securities	24,714,149
Cash from FDIC	45,652,000
Accounts Receivable and Prepaid Expenses	2,261,600
Equipment, Real and Personal Property	3,316,037
Total	$ 86,501,889

Liabilities

Deposits	$112,215,000
Borrowed Money	16,863,553
Other Liabilities	3,933,701
Total	$133,012,254

[Excerpted from Stip. 37]

39. The Agreement provided that the purchasing bank could, within 90 days from closing, resell to the FDIC a maximum amount of $3,000,000 of the loans purchased and could purchase additional loans withheld by the FDIC. [Stip. 33]

40. Under the terms of the Agreement, Southern returned some loans to the FDIC and purchased others. The

net amount of additional loans acquired was $3,216,000 so that the total net face amount of ABT loans acquired was $40,974,953. [Stip. 34]

41. After all adjustments, purchases and returns the face amount of commercial loans acquired from ABT was $23,243,513. [Stip. 35]

42. After all adjustments, purchases and returns the face amount of installment loans acquired from ABT was $17,731,440. [Stip. 36]

43. In preparing their 1974 federal income tax returns, Plaintiffs calculated $5,560,000 to be the amount by which the purchase price exceeded the value of the acquired assets (as adjusted in the post-closing procedure) other than goodwill and the value of the loan portfolio above its face amount. [Stip. 38]

44. The total of the value of the assets, exclusive of loans and any other unspecified intangibles [Stip. 37; Finding 38 above] and the face amount of loans acquired [stips. 35 and 36; Findings 40, 41 and 42 above] less the liabilities assumed [Stip. 37; Finding 38 above] is $5,535,412 and not $5,560,000. The difference between the premiums so calculated and $5,560,000 is not apparent, but in view of Stip. 19 and Finding 21 above the Court finds the premium paid to be $5,560,000.

45. Of that $5,560,000, Plaintiffs determined that $4,993,940 was attributable to the value of the loan portfolio above its face amount and was amortizable for federal income tax purposes over the life of the loan

portfolio that had been acquired. [Stip. 39]

46. Plaintiffs allocated $566,060 to goodwill, which is not amortizable for federal income tax purposes. [Stip. 40]

47. Testimony of Messrs. Balentine and Hummers, officers of Southern, established that at the time Southern calculated its bid they believed that the loan portfolio to be obtained in the transaction was more valuable than its face amount of $40,974,953 because they thought that the quality of the commercial loans was high; the yield on both commercial and installment loans was higher than Southern was then achieving on loans it had in its existing loan portfolio; and

the loans could be acquired without the related cost for underwriting and originating the loans. They testified that the belief that the quality was high had been formed because of the flexible post-closing adjustment procedure and the FDIC's elimination of bad loans.

48. In order to calculate the exact amount of excess value of the commercial loans, Southern performed a statistical analysis whereby it rated the commercial loans based on such factors as interest rate, liquidity of the loan and the borrower, the quality of the collateral securing the loan, and the expected yield. The criteria was developed by Southern's commercial loan officers and credit analysts. The

analysis of the commercial loans was done by Southern's staff of internal auditors. Loans were graded as either excellent, good, average, fair and poor. The loans in the sample which graded as excellent were assigned a premium of 15%; the loans in the sample which graded as good were assigned a premium of 5%; and the remaining loans were either assigned no premium or a discount. The amounts assigned as premiums to the loans in the sample were imputed to the whole commercial loan portfolio. The amount of premium assigned to the commercial loan portfolio was $2,154,918. [Testimony of John Balentine; Plaintiffs' Exhibit 2]

49. Dr. Olin Pugh who testified with the benefit of some considerable

experience as a student of banking expressed his opinion that the procedure was fair and reasonable and would establish a fair value for the commercial loans. Dr. Pugh also expressed approval of the sampling methodology.

50. Robert Davis, the accountant for Southern in 1974, expressed his opinion that the sampling and valuation technique was a "deliberate and thoughtful process" and that the approach was reasonable and fair.

51. The 15%, 5% premium percentages were derived by Messrs. Balentine and Davis from similar transactions engaged in by Southern, from a study of the Seaboard Finance case and from inquiries of other persons

experienced in evaluating and valuing loan portfolios.

52. Mr. Hummers testified that the valuation procedure was later verified by a comparison of the yield on loans originated by Southern with the yield on the ABT loans adjusted to reflect the value of the ABT loans including the premium.

53. The Defendant presented no evidence challenging the valuation technique for the commercial loans, relying instead on argument of counsel to attack the evaluation process.

54. The Court finds that the testimony and credentials of Plaintiffs' witnesses creditable and the inferences drawn reasonable and that the commercial loan portfolio acquired by Southern had

a value in excess of its face amount which was $2,154,918.

55. In order to calculate the amount of excess value of the installment loans, Southern compared its yield on the installment loans originated by it with the yield on the purchased installment loans.

56. Mr. Hummers explained the difference in Southern's pricing decisions with respect to commercial and installment loans. He testified that Southern viewed installment loans to be more homogeneous than commercial loans. Because of the characteristics of installment loans, the principal valuation consideration used by Southern was the yield of the portfolio.

57. Mr. Hummers testified that the value of the installment loan portfolio was calculated by determining the income from the ABT installment loan portfolio and determining the amount of principal which would be required to return the same yield as Southern was then obtaining on the installment loans which it had existing in its portfolio. The precise calculations are set forth in Plaintiffs' Exhibit 2. Those calculations reflect an installment loan portfolio having a value of $19,981,075 composed of a face amount of $17,142,053 and the allocated premium of $2,839,022.

58. Both Dr. Pugh and Robert Davis testified that the valuation technique was fair and reasonable. Mr. Davis testified that he had seen

subsequent calculations which corroborated the value determined and the amount of the premium. Mr. Hummers testified that subsequent calculations had been made on the stream of payments to be received from the acquired installment loan portfolio and that these subsequent calculations verified the original determination. Mr. Davis described these as "internal rate of return" calculations. Mr. Davis testified that this method of calculating value was a commonly accepted method.

59. The defendant presented no evidence or calculations challenging the valuation technique for the installment loans.

60. Defense counsel took the position in oral argument that the loan portfolios would have to be discounted from their face amounts to reflect the time value of money. The Court is mindful that discounting of non-interest bearing obligations would be appropriate to recognize the same principles as the Plaintiffs applied in making their value calculations. However, the testimony established unequivocally that the loan portfolios in question were interest bearing portfolios. Accordingly, any discounting would have to account for the interest bearing nature of the obligations.

61. The Court finds the testimony of Plaintiffs' witnesses and the exhibits submitted creditable and the

inferences drawn therefrom reasonable. The Court also finds that the installment loan portfolio acquired by Southern had a value in excess of face amount which was $2,839,022.

62. Mr. Davis testified that Southern determined a useful life with respect to the acquired commercial loan portfolio by reviewing the life of each loan included in the sample of loans used to determine the premium. Mr. Davis testified that the sample was weighted both as to the term of each loan and the dollar amount of each loan. By comparison of the weighted dollar value of the loans in the sample with the unweighted dollar value of the loans in the sample Southern calculated a life of 4.38 years for the commercial loan portfolio.

63. Southern calculated a useful life for the installment loan portfolio by reviewing a list of the loans made as of October 20, 1974. Mr. Davis testified that the list was sampled to determine the weighted average life of the installments loans. The weighted average life was determined to be 19.91 months, and because the list used was approximately a month old one month was added to arrive at a 20.91 months' average useful life.

64. Both Dr. Pugh and Mr. Davis expressed their opinions that the method used to determine the average life of the loans in the portfolio was reasonable.

65. The evidence suggests that some value could be attributed to the

deposit relationships acquired by Southern in the transaction. Dr. Pugh and Mr. Davis testified that it is possible to estimate a value for deposit relationship. Dr. Pugh testified that the liquidity concerns of ABT had caused it to aggressively seek high cost certificates of deposit in the money markets. He testified that this characteristic made ABT's deposit relationships undesirable.

66. The evidence also suggests that some value could be attributed to the banking locations obtained in the transaction. Dr. Pugh, Mr. Hunt and Mr. Hummers testified that many of the locations obtained were undesirable because the locations were in small communities. Mr. Hunt acknowledged that

the locations have been maintained by Southern even though the branches are only marginally profitable. Dr. Pugh testified that the economic conditions in 1974 suggested that there was very little benefit in aggressive branch openings in small communities.

67. The evidence does not establish a precise value for the deposit relationships acquired or for the locations acquired. The evidence does establish that Southern acquired no goodwill in the traditional sense. The Court finds that the deposit relationships and the locations acquired have some of the characteristics of goodwill. The Court finds that whatever the value of the deposit relationships and the banking locations may have been,

that value did not exceed the $566,060 which Plaintiffs allocated to goodwill for federal income tax purposes.

CONCLUSIONS OF LAW

1. The question presented is whether the Plaintiffs were entitled to deduct for federal income tax purposes, in the form of yearly depreciation deductions, the excess of the cost over the face amount of the loan portfolio acquired from the FDIC.

The decision of the Ninth Circuit in Commissioner v. Seaboard Finance Co., 367 F.2d 646 (9th Cir. 1966) establishes that a portion of the cost of acquiring a loan portfolio may be an identifiable asset subject to depreciation. The issue thus becomes whether the taxpayer has carried its

burden in establishing the cost basis and the life of that asset.

2. Section 167 of the Internal Revenue Code of 1954, as amended, (26 U.S.C. § 167), is the governing statute. That section provides that a reasonable allowance for the exhaustion, wear, tear and obsolescence of property used in a trade or business or held for the production of income shall be allowed as a depreciation deduction. Such a deduction may be claimed for an intangible asset, such as is at issue here, if it is known from experience and other factors to be of use in the business or in the production of income for a limited period, the length of which can be estimated with reasonable accuracy. Treas. Reg. § 1.167(a)-3.

In order to be entitled to a deduction for depreciation, a taxpayer must establish its basis in the property, which is its ascertainable cost, and that the property has a limited useful life, the duration of which can be ascertained with reasonable accuracy. These issues are essentially factual. Houston Chronicle Publishing Co. v. United States, 481 F.2d 1240, 1245-1251 (5th Cir. 1973); Commissioner v. Seaboard Finance Co., 367 F.2d at 652. Also, when an asset is acquired which is only partially depreciable, the basis for the asset must be allocated to the depreciable and non-depreciable components in accordance with their respective fair market values. Treas. Reg. § 1.167(a)-5.

3. Based on the evidence presented, the Court concludes that Plaintiffs have met their burden of proof in establishing that the value of the assets acquired were separable from the value of goodwill and the values of any other nondepreciable assets that may have been present. The fact that the Purchase Agreement did not provide an allocation of the purchase price to the loan portfolios is not fatal. See Laird v. United States, 556 F.2d 1224 (5th Cir. 1977); Miami Valley Broadcasting Corp. v. United States, 499 F.2d 677 (Ct. Cl. 1974). Southern, through reasonable valuation methods, calculated the total purchase price allocable to the loan portfolio to be $45,968,893 and as part of this same process has

allocated $4,993,940 as the depreciable amount and $40,974,953 as the non-depreciable face amount element of value acquired in the ABT acquisition.

4. Treas. Reg. § 1.167(a)-3 requires that the useful life of an asset be estimated with "reasonable accuracy." In Seaboard Finance Co., the taxpayer established the average useful life of the loans that it purchased based on its experience. Here, the Plaintiffs established the useful life by a weighted sampling method based on the contractual terms of the loans. Such a method complies with the requirement of the regulation that the period of usefulness be determined with "reasonable accuracy." Accordingly, the Plaintiffs carried their burden of proof

in establishing that the average useful life of the commercial loans was 4.38 years and the average useful life of the installment loans was 20.91 months.

5. Based on the record, and as found by the Court above, Southern did not acquire any of the traditional elements of goodwill. E.g., Houston Chronicle Publishing Co., 481 F.2d at 1247. The value obtained by acquiring locations and deposit relationships was shown by Plaintiffs to be no greater than $566,060. These elements of value are sometimes viewed as a component of goodwill while in other instances they have been treated as separate nondepreciable assets. Compare Winn-Dixie Montgomery, Inc. v. Commissioner, 444 F.2d 677 (5th Cir.

1971) with Concord Control, Inc. v. Commissioner, 615 F.2d 1153 (6th Cir. 1980). Under either view, the value acquired as the result of obtaining new banking locations and depositors has been adequately accounted for by Plaintiffs.

6. Accordingly, the Plaintiffs established that they acquired an identifiable asset in the form of the loan portfolio and that the value of that loan portfolio exceeded its face amount. Therefore, Plaintiffs properly allocated a portion of the purchase price to the value of the loan portfolio in excess of its face amount. Also, Plaintiffs have carried their burden in establishing with reasonable accuracy the life of the loan portfolio as a depreciable asset.

Plaintiffs, therefore, are entitled to a refund of federal income taxes and interest on such taxes in the amount set forth in a judgment to be entered pursuant to these Findings of Fact and Conclusions of Law.

This 5th day of May, 1983.

UNITED STATES DISTRICT JUDGE

JUDGMENT

UNITED STATES COURT OF APPEALS

for the

Fourth Circuit

No. 83-1838
C/A 82-2018 - 82-2024-3

SOUTHERN BANCORPORATION, INC. AND SUBSIDIARIES; WORLD FINANCE CORPORATION OF AMERICUS; SOUTHERN BANK AND TRUST COMPANY; COLONIAL LOAN AND FINANCE OF ALBANY; BELVEDERE FINANCE COMPANY, INC. OF ANDERSON; WORLD FINANCE CORPORATION OF PALESTINE and WORLD FINANCE CORPORATION OF TEXAS CITY,

Appellees,

vs.

UNITED STATES OF AMERICA,

Appellant.

Appeal from the United States District Court for the District of South Carolina.

This cause came on to be heard on the record from the United States District Court for the District of

South Carolina, and was argued by counsel.

On consideration whereof, It is now here ordered and adjudged by this Court that the judgment of the said District Court appealed from, in this cause, be, and the same is hereby, reversed and remanded to the United States District Court for the District of South Carolina at Greenville for further proceedings consistent with the opinion of this court filed herewith.

_____

CLERK

UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT
No. 83-1838

Southern Bancorporation, Inc. and Subsidiaries; World Finance Corporation of Americus; Southern Bank and Trust Company; Colonial Loan and Finance of Albany; Belvedere Finance Company, Inc. of Anderson; World Finance Corporation of Palestine and World Finance Corporation of Texas City,

Appellees,

versus

United States of America,

Appellant.

O R D E R

Upon consideration of the appellees' petition for rehearing and suggestion for rehearing en banc, and no

judge having requested a poll on the suggestion for rehearing en banc,

It is ADJUDGED and ORDERED that the petition for rehearing is denied.

Entered at the direction of Judge Murnaghan for a panel consisting of Judge Murnaghan, Judge Chapman, and Judge Peck (Senior U. S. Circuit Judge, Sixth Circuit).

For the Court,

_____

CLERK

Office-Supreme Court, U.S.
FILED
JAN 18 1985
ALEXANDER L. STEVAS,
CLERK

(3)

No. 84-307

In the Supreme Court of the United States

OCTOBER TERM, 1984

SOUTHERN BANCORPORATION, INC., PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

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QUESTION PRESENTED

Whether the court of appeals, reversing the district court, correctly determined that petitioners had failed to introduce probative evidence to establish that the fair market value of a portfolio of bank loans exceeded the face value of the loans.

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BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. A1-A23) is reported at 732 F.2d 374. The opinion of the district court (Pet. App. A24-A71) is unreported.

JURISDICTION

The judgment of the court of appeals (Pet. App. A72-A73) was entered on April 17, 1984. A petition for rehearing was denied on May 30, 1984 (Pet. App. A74-A75). The petition for a writ of certiorari was filed on August 28, 1984. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

Petitioner Southern Bancorporation is a bank holding company. One of its subsidiaries, petitioner Southern Bank and Trust Company (Southern), is a South Carolina bank based in Greenville. American Bank and Trust Company (ABT) was another South Carolina bank which, unlike

Southern, had experienced financial difficulties. On September 19, 1974, the FDIC notified Southern and five other South Carolina banks that ABT would be closed by state banking authorities on the following day (Pet. App. A33). The FDIC solicited bids from the six banks for ABT's operations (*id.* at A33-A34).

Under the terms of the bidding, the successful bidder was required to assume $136 million of ABT's liabilities, which consisted mostly of checking and savings accounts (Pet. App. A34-A35). The FDIC agreed to take over from ABT questionable loans with a face amount of $61 million (*id.* at A5). The successful bidder would acquire ABT's other assets, consisting of loans with a face amount of $41 million, cash and securities worth $35 million, and other assets with a fair market value of $6 million (*id.* at A47-A48). The FDIC agreed to make up in cash the difference between the value of the assets to be acquired and the amount of liabilities to be assumed, with the stipulation that any "premium" bid by the assuming bank would be subtracted from the FDIC's promised cash infusion (*id.* at A37). The "premium" offered by the banks bidding for ABT's operations thus equalled the amount of "excess liabilities" they were prepared to assume.

In preparing their bid, Southern's officers ascertained that Crocker National Bank of San Francisco had recently acquired a bank from the FDIC in a similar transaction, bidding a premium equal to 5% of the acquired bank's deposit base.[1] Based primarily on the Crocker transaction,

---

[1]This is a standard formula used by bankers in determining the going-concern value of a bank. See *Banco Nacional de Cuba* v. *Chase Manhattan Bank*, 505 F. Supp. 412, 461 (S.D. N.Y.), modified, 514 F. Supp. 5 (1980), modified and aff'd, 658 F.2d 875 (2d Cir. 1981); *Midlantic National Bank* v. *Commissioner*, 46 T.C.M. (CCH) 1464, 1466-1467, 1471 (1983). See also 1 A.S. Dewing, *The Financial Policy of Corporations* 304-305 (5th ed. 1953).

Southern submitted a bid of $5,560,000, an amount that approximated 5 percent of ABT's $112 million in deposits (Pet. App. at A8, A48). Those deposits were maintained in 29 ABT branch banks located in some 20 South Carolina communities, none of which was currently served by Southern (Pet. App. A7; C.A. App. 169-172, 174-176).

Southern submitted its bid on Friday, September 20, 1974, the day after the FDIC's solicitation. Within a few hours it was notified that it was the successful bidder (Pet. App. A37-A38). In accordance with the FDIC's terms, Southern sent teams of its employees to all of ABT's branch banks over the weekend to remove signs referring to "American" and to replace them with signs referring to "Southern." On the following Monday morning, all former ABT branches opened for business as branches of Southern. Television, newspaper and radio advertising was purchased to assure depositors that their funds were safe. Southern continued to operate 26 of ABT's 29 branches throughout the nine years between its acquisition of ABT and the trial below; three branches were closed or consolidated at some point. Pet. App. A20-A21 & n.9, A37-A40; C.A. App. 433-436.

In preparing its 1974 federal income tax return, Southern sought its accountants' advice about the proper characterization for tax purposes of the $5,560,000 premium that it had paid to acquire ABT. As noted above, that premium represented the excess of the liabilities that Southern assumed over the face amount of ABT's loan portfolio plus the fair market value of ABT's other assets. The accountants suggested that, because the FDIC had taken over many of ABT's bad loans, ABT's remaining loans were of high quality, *i.e.*, were relatively more likely to be repaid, and hence allegedly had a fair market value in excess of face. Southern and its accountants then devised a complicated methodology for valuing the loans. ABT's installment loans

(*e.g.*, car and boat loans), which had a face value of $18 million, were determined to have a fair market value of $21 million on the theory that their yield was slightly higher than the average yield on Southern's existing portfolio of installment loans (Pet. App. A56-A57). ABT's small business loans, which had a face value of $23 million, were sampled and graded according to their "quality" — essentially, their likelihood of being repaid — and were assigned premiums based on quality, to produce an asserted fair market value of $25 million (*id.* at A52-A53). Based on these calculations, Southern concluded that the fair market value of ABT's loan portfolio exceeded its face value by $5 million, that $5 million of the $5,560,000 premium Southern had paid thus represented a "loan acquisition cost," and that this loan acquisition cost should be amortized (deducted) for federal tax purposes over the useful lives of the loans. Petitioners accordingly claimed an amortization deduction for 1974 in the amount of $589,241, producing an operating loss which they sought to carry back to generate tax refunds for prior years (*id.* at A12). Southern allocated the balance of the premium it had paid to acquire ABT —$560,000 — to "goodwill," *i.e.*, to the going-concern value of ABT's business (*id.* at A64). Goodwill is not amortizable for federal tax purposes and no tax deductions can be claimed with respect to it.

On audit, the Commissioner determined that the fair market value of ABT's loan portfolio was, if anything, lower than its face value, since the loans' average yield was lower than market interest rates prevailing in September 1974. In the Commissioner's view, therefore, no part of the $5,560,000 premium could reasonably be characterized as a loan acquisition cost, since no one would pay a "premium" to acquire a loan portfolio with a below-market interest rate. The Commissioner determined, rather, that Southern had paid the $5,560,000 premium to acquire the going-concern value represented by ABT's chain of 29 branch

banks and its established relationships with its depositors, borrowers, and other customers. Since goodwill is not amortizable for tax purposes, the Commissioner disallowed Southern's claimed amortization deduction.

2. Petitioners paid the resulting deficiencies and sued for refunds in the United States District Court for the District of South Carolina. In support of their claimed amortization deduction, petitioners relied exclusively on testimony concerning the "quality rating" methodology described above (Pet. App. A51-A60). The government argued that petitioners' methodology was defective as a matter of law; that the loans were worth less, not more, than face; and that the evidence showed Southern to have paid the $5,560,000 premium for ABT's going-concern value (Pet. App. A14, A55; C.A. App. 406-419). The district court rejected the government's arguments, finding that the loan portfolio's fair market value exceeded its face value by $5 million as petitioners contended (Pet. App. A55-A60). The court acknowledged that "the deposit relationships and the locations acquired [by Southern] ha[d] some of the characteristics of goodwill," but found that, "whatever the value of the deposit relationships and the banking locations may have been, that value did not exceed the $566,060 which [petitioners] allocated to goodwill for federal income tax purposes" (*id.* at A63-A64).

The court of appeals unanimously reversed (Pet. App. A1-A23). It noted that petitioners bore the burden of proving their entitlement to a refund (*id.* at A18) and concluded that they had not "sufficiently established" by competent evidence the fair market value of the loan portfolio (*id.* at A17 n.8). Southern, the court noted, had done "nothing to establish that a sale of the loan portfolios on the open market on the sale date * * * by a willing seller to a willing buyer would have yielded any greater sum" than the face values of the loans as set forth in the FDIC prospectus (*id.*

at A18-A19). The court observed that the manner in which Southern had determined its $5,560,000 bid —multiplying ABT's $112,000,000 deposit base by 5% — necessarily evidenced a primary focus on the going-concern value of the ABT branch banks in which those deposits were maintained (*id.* at A8-A9). And the court concluded that the "quality rating" methodology Southern later used to support its alleged $5 million loan acquisition cost — a methodology that was "totally *post hoc*" since Southern did not evaluate (and had no time to evaluate) the quality of the loans before purchasing them (*id.* at A15, A16-A17) — was "comprised exclusively of imagination and speculation" (*id.* at A21). The court accordingly held that the district court had erred in failing to enter judgment for the United States.

ARGUMENT

1. Petitioners assert that the court of appeals did not base its reversal on a determination that the district court's findings were clearly erroneous or that its reasoning was legally deficient, but simply substituted its judgment for that of the trier of fact (Pet. 5, 12-18). Petitioners accordingly maintain that the court of appeals' holding violates Rule 52(a) of the Federal Rules of Civil Procedure, and that it conflicts with various decisions applying that Rule (Pet. 23-24).

Petitioners' assertion is altogether without merit. Although the court of appeals did not explicitly employ the words "clearly erroneous," it determined that the district court's finding of ultimate fact (the fair market value of the loan portfolio) was incorrect, because the only evidence petitioners introduced to support that asserted value (the "quality rating" methodology) was inherently defective as a matter of law. Indeed, petitioners make no attempt to defend their "quality rating" methodology, and at no point do they even contend that the Fourth Circuit erred in finding it faulty. Because the court of appeals applied the correct standard of review, and because the sole remaining

question is an essentially factual one concerning the fair market value of property, this case does not warrant further review.

The court of appeals' holding on the valuation question, moreover, was manifestly correct. As the court observed (Pet. App. A18-A19), petitioners did not introduce any evidence to show what the ABT loan portfolio would have sold for in the open market. Nor did petitioners show that the ABT loans bore a higher interest rate than the rate prevailing in September 1974 for loans of comparable terms and risk, as would necessarily be the case if the loans were worth more than their face amounts. Petitioners thus ignored the fundamental principle of tax law that fair market value must be determined objectively by reference to what a willing buyer would pay a willing seller in the open market. See, *e.g., Kimball Laundry Co.* v. *United States*, 338 U.S. 1, 6 n.3 (1949).

Instead of introducing probative evidence of this sort, petitioners relied solely on testimony about their "quality rating" methodology in an effort to demonstrate that the ABT loans were worth $5 million more than face. This methodology, however, was defective as a matter of law and could produce no probative evidence of fair market value. The fact that the average yield on the ABT loans was higher than the average yield on Southern's existing portfolio of loans (Pet. App. A56-A57), for example, is irrelevant in determining whether the ABT portfolio was worth more than its face amount. Obviously, if both sets of yields were lower than prevailing market rates, *both* portfolios would be worth less than face, although ABT's portfolio might be relatively more valuable than Southern's.

Similarly, the fact that the ABT loans Southern acquired were of higher "quality" than the ABT loans the FDIC took over (Pet. App. A52-A53) is also irrelevant to the question of fair market value. A Treasury bond bearing a 5% interest

rate, at a time when market interest rates have risen to 12%, is virtually certain to be repaid and would merit a high "quality premium" under Southern's formula, despite the fact that the fair market value of such a bond would be less than face prior to maturity. Obviously, the "quality" of ABT's loans was reflected in the interest rate ABT originally charged its borrowers. Absent evidence that those borrowers' creditworthiness had improved —evidence that Southern did not offer, and evidence that might be hard to come by given ABT's failing circumstances — the "quality" of the loans would not cause them to be worth more than their original face amounts.[2]

In sum, petitioners introduced no probative evidence of the loan portfolio's fair market value. The court of appeals thus held correctly (Pet. App. A22-A23) that they had failed to carry their burden of proof.[3]

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[2]Indeed, what little hard evidence Southern did submit indicated that ABT's loans were worth less, not more, than face. For example, the average yield on the ABT installment loans — car and boat loans generated over several years — was about 10.6% (C.A. App. 46). During the two-year period immediately preceding Southern's acquisition of those loans, however, the prime rate had risen from 5.5% to 12%. 60 Fed. Res. Bull. A32 (1974); 60 Fed. Res. Bull. A28 (1974). It is thus obvious that those loans were worth less than their face amounts. Compare C.A. App. 46 (average yield on ABT commercial loans was 8.4%) with C.A. App. 47 (federal funds rate estimated to be about 10.25%).

[3]Petitioners repeatedly criticize the court of appeals (Pet. 13, 15, 25) for suggesting that the "quality rating" methodology petitioners employed at their accountants' suggestion amounted to "ingenuity approaching fraud" (Pet. App. A3). While we would not necessarily subscribe to that characterization, the court of appeals was not without record support for its observation. In a financial statement filed with the SEC shortly after Southern acquired ABT, petitioners' accountants took the position that the $5,560,000 premium was properly to be treated as an intangible asset and amortized over 40 years. This reflects the accountants' understanding that the premium was attributable to goodwill or other intangible assets (such as going-concern value) not specifically identifiable having a useful life of 40 years, and not, as the accountants testified below, to a specifically identifiable portfolio of

2. This case has nothing to do with *Anderson* v. *City of Bessemer City*, No. 83-1623 (argued Dec. 3, 1984). The question there is whether the Fourth Circuit misapplied the "clearly erroneous" standard of review prescribed by Fed. R. Civ. P. 52(a) in reversing the district court's findings of fact in an employment discrimination case involving credibility and motivational determinations. The instant case does not arise in such a context and the factual questions it presents are of a wholly different nature. Here, the court of appeals' reversal was premised on a conclusion that petitioners' "quality rating" methodology did not constitute probative evidence of fair market value as a matter of law —a conclusion that has no parallel in *Anderson* and which wholly eliminated any evidentiary basis for the district court's judgment. There is accordingly no reason to hold this case pending decision in *Anderson*.

3. Finally, petitioners err in contending (Pet. 30-34) that they are entitled to a remand for determination of their alternative claim that the $5,560,000 premium was paid for ABT's deposit base, and that they are entitled to amortize that premium over the deposits' (as opposed to the loans') useful lives (Pet. 31 n.5). As the court of appeals stated (Pet. App. A9-A10 n.2), petitioners abandoned that alternative argument and introduced no evidence whatever of the expected "useful life" of the deposits involved. There is thus no basis for a remand on that issue. See *United States* v. *Janis*, 428 U.S. 433, 440 (1976) (taxpayer in a refund suit has the burden of establishing not only that the Commissioner's determination was wrong, but also of producing evidence to demonstrate his correct tax liability).

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loans having a useful life of less than five years. See AICPA Accounting Principles Board, Op. 16, at ¶¶ 42-44, 87; Op. 17, at ¶¶ 28-29 (1970); Financial Accounting Standards Board, *Interpretation No. 9, Applying APB Opinions No. 16 and 17 When a Savings and Loan Association or a Similar Institution is Acquired in a Business Combination Accounted for by the Purchase Method* at ¶ 8 (1976).

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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